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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1932

No. 517

PUBLIC SERVICE COMMISSION OF WISCONSIN, THEODORE KRONSHAGE, JR., INDIVIDUALLY AND AS A COMMISSIONER OF SAID PUBLIC SERVICE COMMISSION OF WISCONSIN, ET AL., ETC., APPELLANTS,

vs.

WISCONSIN TELEPHONE COMPANY.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WISCONSIN.

MOTION TO AFFIRM AND REPLY TO APPELLANTS' STATEMENT AS TO JURISDICTION.

EDWIN S. MACK,
ARTHUR W. FAIRCHILD,
J. GILBERT HARDGROVE,
Counsel for Wisconsin Telephone Company, Appellee.

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vs.

WISCONSIN TELEPHONE COMPANY, A WISCONSIN CORPORATION, APPELLEE.

MOTION TO AFFIRM.

The above named appellee, Wisconsin Telephone Company, moves that the decree appealed from in

the above entitled cause be affirmed, on the ground that the decree appealed from is one resting in the discretion of the trial court where the discretion of the court below was not abused, and that the questions on which the decision of the cause involved in said appeal depends are so unsubstantial as not to need further argument.

EDWIN S. MACK,
ARTHUR W. FAIRCHILD,
J. GILBERT HARDGROVE,
Counsel for Wisconsin Telephone Company, Appellee.

SUPREME COURT OF THE UNITED STATES.

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vs.

WISCONSIN TELEPHONE COMPANY, A WISCONSIN CORPORATION, APPELLEE.

STATEMENT OF APPELLEE (COMPLAINANT) IN REPLY TO STATEMENT OF THE APPELLANTS (DEFENDANTS) AS TO JURISDICTION OF THE SUPREME COURT OF THE UNITED STATES AND MATTERS IN WHICH IT IS CLAIMED THAT THE DISTRICT COURT HAS ABUSED ITS DISCRETION, AND IN SUPPORT OF MOTION TO AFFIRM FILED HEREWITH.

A.

Jurisdiction of Supreme Court.

It is not controverted that the appeal comes within Section 266 of the Judicial Code as amended.

B.

Alleged Abuse of Discretion.

I and II.

Alleged Absence of Prima Facie Determination of the Facts and/or Law Which Constitute Confiscation.

Alleged Absence of "Hearing and Determination" Required by the Judicial Code.

The recital of proceedings by the defendants* is outside of the record and therefore not before the court, and even so, is incomplete and misleading in suggesting a failure on the part of the court to give adequate consideration to the case. One of the so-called recesses to which the defendants allude was the one in which the court reached its determination, and on reconvening made the announcement of its decision. That announcement included, besides a grant-

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*For convenience, we follow the practice of the appellants' Statement in using the designation of the parties in the trial court, namely, "complainant" and "defendants" for the appellee and appellants, respectively.

ing of the injunction, a specification as to the amount of the bond and the conditions as to the safeguards as to security. The members of the court had indicated by their discussion with counsel during the argument, their appreciation of the questions involved and their views thereon.

The recitals in the formal written decree are in conformity with the statute. The defendants recite the voluminousness of the record which the Commission had before it preliminary to the issue of the order herein enjoined. That record was not before the court; and further, as hereinafter set forth, it included only evidence presented by the appellant Commission itself and that without completing the Commission's case. So far as the record in the case at bar is concerned, a very large part of it is devoted to corroborating facts and details of methods, computations, etc., in support of the issue of confiscation. Besides having printed copies of the pleadings and affidavits before each member of the court, the matters covered were placed before the court, so far as was required, in the arguments of counsel.

It is true, literally, as stated by defendants that "every material allegation of the bill of complaint was specifically answered" but the answer made to many important allegations was merely a denial on information and belief, and other material allegations were covered merely by denial of knowledge.

The fact that an interlocutory injunction, granted by a statutory three-judge court, was rendered without opinion does not change the rule as to its consideration by the Supreme Court.

See *Mitchell, Atty. Gen.* v. *Penny Stores, Inc.*, 284 U. S. 576.

III.

Allegation That the Interlocutory Injunction Has the Effect of a Permanent Injunction.

The defendants allege that the Commission's order will expire by its own terms not later than July 31, 1933, and maintain that the cause cannot be decided on the merits by that time. While the defendants' statements show a misapprehension of the statement of complainant's counsel as to the time required for preparation for trial, there is at least a possibility that this case will not be determined prior to July 31, 1933. That, however, does not make the present interlocutory injunction a permanent injunction or prevent the effectiveness of the Commission's order or work any injustice.

The defendants' statement ignores the fact that the complainant was required to give bonds as a condition of the injunction; and under this bond, if it be finally adjudicated that an interlocutory injunction should not have been granted or it be finally decreed that the order of the Public Service Commission was lawful and that the schedule of rates ordered to be placed in effect was lawful and should have been allowed, the complainant must refund to its several subscribers the sums paid by them in excess of those chargeable according to said order of said Public Service Commission, and there is further reserved to the court determination of the question of interest on any refunds. Thus there is provision so that in event of the

defendants being successful in the suit, the result will not be that of a final injunction in favor of the complainant, but on the contrary, in such event the defendants and all the subscribers of the complainant will be placed in the same position as if this suit had not been brought and no injunction had been issued.

Remedy on the injunctional bond can be granted by the trial court in the principal case if the decision is adverse to the complainant.

Russell v. *Farley*, 105 U. S. 433, 442, 445.

Pease v. *Rathbun-Jones Eng. Co.*, 243 U. S. 273, 279.

Further, an interlocutory injunction is subject at all times to dissolution or modification by the court granting it.

Barnard v. *Gibson*, 7 How. 650, 658.

Buffington v. *Harvey*, 95 U. S. 99, 100.

Russell v. *Farley*, 105 U. S. 433, 441.

Westerly Waterworks v. *Town of Westerly*, 77 Fed. 783, 784.

In re Arkansas Railroad Rates, 168 Fed. 720, 722.

Twenty-one Mining Co. v. *Original Sixteen to One Mine, Inc.*, 240 Fed. 106, 110.

In re Jackson, 9 Fed. 493, 495.

IV.

Allegation of Issue of Interlocutory Decree Without Reservation to the Public Service Commission of Power to Make a Permanent Order After Completion of Its Investigation and After Expiration of the Temporary Order Expiring on July 31, 1933.

The interlocutory injunction in this cause does not purport to prevent the Commission from making a permanent rate order after expiration of the temporary rates provided for in the Commission's order of June 30, 1932. The decree directs the injunction of the defendants, etc., from attempting to compel the complainant, its agents, etc., "to observe or put in force the rates for telephone service prescribed by the order of the defendant Public Service Commission," etc. [designating the order in controversy], or to comply with said order, and also the injunction of the defendants, etc., from attempting to enforce any penalties or other remedies "for disregarding the rates prescribed by said order" or failure to comply with said order. The rates prescribed by said order are rates to "be effective for a period of one year unless the Commission shall in the meantime alter or amend this [said] order". Therefore, at the end of the year designated in the Commission's order, the force of the injunction is spent.

Further, if circumstances should so change as to make it proper to put into effect rates by a permanent order and the interlocutory injunction would be an interference with it, the Commission could present

the matter to the trial court by motion for dissolution or modification of the interlocutory injunction.

See cases cited *supra*.

C.

Affirmance Because the Questions Involved are Unsubstantial.

Pursuant to paragraph 3 of rule 12, the complainant presents herewith its motion to affirm under paragraph 4 of rule 7 of the Supreme Court.

I.

An interlocutory injunction is not to be enjoined unless there is an abuse of discretion.

Alabama, et al. v. *U. S.*, 279 U. S. 229, 231.

Broad-Grace Arcade Corp. v. *Bright*, 284 U. S. 588.

Mitchell, Atty. Gen. v. *Penny Stores, Inc.*, 284 U. S. 576.

Averill v. *Northwestern Natl. Ins. Co.*, 284 U. S. 590.

Binford v. *McLeaish*, 284 U. S. 598.

It is further the rule that:

> "Where the questions presented by an application for an interlocutory injunction are grave, and the injury to the moving party will be certain and irreparable if the application be denied and the final decree be in his favor, while if the injunction be granted the injury to opposing party, even if the final decree be in his favor, will be inconsiderable, or may be adequately indemnified by a bond, the injunction usually will be granted."
>
> *Ohio Oil Co.* v. *Conway*, 279 U. S. 813, 815.

The interlocutory injunction in the case at bar comes strictly within this rule.

The complainant has more than 265,000 subscribers and the average monthly bills rendered to them is less than $5.10 each. If the rate reduction prescribed by the Public Service Commission were permitted to become effective, the complainant would have no possibility of collecting back the difference between the rates ordered by the Commission and its lawful rates, in event of a decree holding the rates prescribed by the Commission's order unlawful; whereas, under the bond prescribed by the trial court's decree for injunction, provision is made for complete restitution to the complainant's subscribers if the enforcement of the rates should not have been enjoined.

The defendants have called attention to the fact that the Commission's order is a temporary order in effect for only one year and that the case may not be determined within a year. This means that if an interlocutory injunction were not granted, the Commission's order might have had its entire efficacy before a final decree would be entered, so that the denial of an interlocutory injunction would be tantamount to a final and irrevocable decree against the complainant.

II.

The statement of the issues made by the defendants fails to present adequately the scope of the complaint, the uncontroverted matters, the basis of the Commission's order and the nature of the issues raised in the cause, all of which required the court to decree an interlocutory injunction.

The defendants' statement states that the Commission's "order reduces certain telephone rates of the Wisconsin Telephone Company, complainant, by 12½ per cent." The "certain rates" referred to are all rates for all of the complainant's 96 exchanges in Wisconsin, excepting a few insignificant rates for minor services; and the reduction of 12½ per cent of the rates ordered by the Commission amounts to a reduction of over 67 per cent of the complainant's net income from its exchanges according to its actual expenditures, and to over 40 per cent of the income computed by the Commission after disallowing substantial expenditures and then providing for only the cost of the "local" part of exchange service. (See page 13, *infra*.)

The affidavits presented by the complainant clearly show confiscation, setting forth in detail the value of the complainant's property, its operating expenses and return, and covering severally the complainant's entire telephone service, its entire exchange service, its entire local service, its entire intrastate service, its entire intrastate exchange service and its entire intrastate local service; and they show that on no one of these would the Commission's order have permitted a return of more than 2.2 per cent to be earned in the year 1931 or even 2 per cent in the first six months of 1932, the latest period available. The valuation was made by complainant's chief engineer, who was thoroughly familiar with the property, and it was corroborated as to method, present condition of the property and price basis by independent engineers and appraisers. It was not controverted that these affidavits made a case of confiscation. Such valuations as were

presented by the defendants' affidavits were based on computations of present condition by deduction of the depreciation reserve—a method legally indefensible (*McCardle* v. *Indianapolis Water Co.*, 272 U. S. 400, 416)—and even that, not according to the company's books, but on a theoretical allocation thereof by the Commission. The defendants merely denied knowledge as to the value of the property used and useful for intrastate telephone service and likewise as to that devoted to the toll service.

The Commission's order fixing rates has an elaborate discussion by which it sought to reduce or exclude certain items of expenses, the facts and theory of which were disputed by the complainant; but the Commission's order made no attempt to value the complainant's property, specifically disclaiming such attempt (order, page 93), and in all the tabulations in the order, there nowhere appears the company's balance sheet.

The basis of rate-making used by the defendant Commission was to provide for a dividend of 6 per cent on that portion of the par value of the common stock of the company which the Commission allocated to its *local service* after making arbitrary exclusions from the complainant's actual expenses; and the Commission computed its *rates for exchange service* to yield this 6 per cent return on the portion of the common stock allocated by it to *local service* with a theoretical additional allowance of $288,000 (approximately 18 per cent of the theoretic 6 per cent dividend requirement) to cover possible contingencies. This was the only consideration, express or implied, given to a return on the company's surplus, amounting to ap-

proximately 22 per cent of the outstanding common stock.

By *local service* is meant the service between subscribers to an exchange as among themselves, as distinguished from what we have designated as "*terminal toll service*," which is the service furnished by exchange facilities and through exchange operation in making the portion of a toll call between a subscriber's telephone station and the toll switchboard. Certified copies of previous orders of the Commission, which are in the record here, show that the complainant's message rates for toll service cover only the furnishing of toll service from a toll switchboard in one exchange to the toll switchboard in another exchange and that the service rendered by the exchange facilities between the toll switchboard and the subscriber's station was classified as part of the *exchange service* and covered by the *exchange rates*.

The Commission's order on its face does not absolve the complainant from furnishing this *terminal toll service* as part of its *exchange service*, but nonetheless it purports to fix the complainant's entire return for all *exchange service* on the basis of the capital stock allocated by the Commission to the *local service* alone, and with provision only for paying the expenses incurred in furnishing the *local service*. Quite aside from the question of confiscation arising from the Commission's method of finding its rate base and its rate of return, the order on its face is confiscatory in fixing an exchange rate that makes no compensation whatever for the terminal toll service required to be furnished as a part thereof.

The Commission's order assumes the theory that if the result of the order is to make too low the complainant's compensation for its toll service (dealt with as including terminal toll service also), the complainant can apply for an increase thereof. This ignores the fact that the toll rates were already before the Commission in the same "State-Wide" proceeding in which the order in question was made; that no stay or relief was provided while the toll rates would be under consideration; and that the complainant was still left immediately and continuously under the duty of providing terminal toll service under its exchange rates, although the Commission now computed those rates on the basis of only the operating expenses and the capital stock allocated to local service alone. The attention of the Commission was called to this in the complainant's statutory application for rehearing, which the Commission denied the same day it was argued.

On the rate of return, the complainant's proof showed 8 per cent to be a reasonable return. This was controverted by the defendants; but it is undisputed that the 7 per cent cumulative preferred stock of the complainant was selling at about par. This preferred stock is preferred both as to principal and income and has behind it the security of common stock amounting to 800 per cent of the preferred stock and of a surplus of approximately 175 per cent more.

The Commission's order, while made in a state-wide investigation of the complainant's entire telephone system, both exchange and toll, sought to reduce the rates on the 96 exchanges of the complainant treated as an entirety, without regard to the toll income, al-

though the only reason the 96 exchanges could be treated as a whole and unified was because of the toll connection between them. On the face of the Commission's own order and making the allocations of property and expenses made by the Commission, the return on the complainant's toll service would become reduced to approximately 1 per cent.

A telephone company's franchise in Wisconsin is one state-wide, granted under general statute comprehending toll as well as exchange services; and the unity of its character is shown by the fact that it is classified with franchises of telegraph companies and transmission companies and is not a subject for local grant.

Wisconsin Stats., § 180.17.

Kenosha v. *Kenosha Home Tel. Co.*, 149 Wis. 338.

Besides the grounds of confiscation above set forth, the complaint and affidavits presented by the complainant also show that the Commission had no power to make any reduction of rates because the complainant's existing rates were not unreasonable, and that there was no emergency under the Wisconsin statutes justifying the Commission's so-called emergency order. In addition, the complaint and affidavits further show lack of due process of law and the equal protection of the law in the defendant Commission's proceedings, in that the Commission made its order without the complainant having an opportunity to be heard and without any notice that the Commission intended or contemplated the making of a temporary or emergency order or would take that or any other action before the

complainant should be heard and the investigation closed.

The record before the Commission was voluminous but it consisted entirely of evidence presented by the Commission, who was protagonist in the proceeding, and as the Commission had not yet closed its case, presentation of evidence on behalf of the complainant had not yet begun. In fact, at the time the order was made, the cross-examination of some of the Commission's witnesses had not yet been completed. The complaint and affidavits set forth other improprieties in the Commission's proceedings, which it is not necessary to enter into here.

We have gone into this general summary because it shows that the interlocutory injunction was properly granted, and that far from there being an abuse of discretion in granting it, there would have been an abuse of discretion in refusing the injunction under the principle of the case of *Ohio Oil Co.* v. *Conway*, 279 U. S. 813, 815.

As further showing the legal grounds necessitating the interlocutory injunction in this cause, there is annexed as an appendix hereto, a copy of the complainant's brief submitted to the trial court, with the addition of a subject index and table of cases.

Respectfully submitted,

EDWIN S. MACK,
ARTHUR W. FAIRCHILD,
J. GILBERT HARDGROVE,
FREDERIC SAMMOND,
Solicitors and Counsel for Complainant (Appellee).

APPENDIX.

Copy of Complainant's Brief Submitted to the Trial Court, with Addition of Subject Index and Table of Cases.

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IN THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WISCONSIN.

In Equity. No. 2118.

WISCONSIN TELEPHONE COMPANY, *a Wisconsin Corporation, Complainant,*

vs.

PUBLIC SERVICE COMMISSION OF WISCONSIN, THEODORE KRONSHAGE, JR., *et al., Defendants.*

COMPLAINANT'S BRIEF.

I.

The Complainant is Entitled to an Injunction.

The rule is laid down in *Ohio Oil Co.* v. *Conway*, 279 U. S. 813, as follows:

> (279 U. S. 814) "* * * But enough appears to make it plain that there is a real dispute over material questions of fact which can not be satisfactorily resolved upon the present affidavits and yet must be resolved before the constitutional validity of the amendatory statute can be determined.
>
> * * * Where the questions presented by an application for an interlocutory injunction are grave, and the injury to the moving party will be certain and irreparable if the application be denied and the final decree be in his favor, while if the injunction be granted the injury to opposing party, even if the final decree be in his favor, will be inconsiderable, or may be adequately indemnified by a bond, the injunc-

tion usually will be granted. *Love* v. *Atchison, Topeka & Santa Fe R. Co.*, 185 Fed. 321, 331-332."

To the same effect is

Love v. *A. T. & S. F. Ry. Co.*, 185 Fed. 321, 331.
Prendergast v. *N. Y. Tel. Co.*, 262 U. S. 43.
Indiana General Service Co. v. *McCardle*, Statutory Court, S. Dist. of Ind., July 19, 1932.

II.

Scope of Federal Jurisdiction.

Federal jurisdiction having attached on the federal question arising under the Constitution, the court also must consider all other questions involving the validity of the Commission's Order and may grant the plaintiff relief asked on these allegations irrespective of the decision on the constitutional points.

Siler v. *L. & N. Ry.*, 213 U. S. 175.
Risty v. *C. R. & I. P. Ry.*, 270 U. S. 378, 387.

The answer alleges that the complainant has an adequate remedy at law to set aside the Commission's Order under Section 196.41 of the Wisconsin statutes and that the defendant had a remedy by injunction under Section 196.43 of the statutes. The word "action" in the Wisconsin statutes embraces suits in equity as well as at law.

Wis. Stats., Sec. 260.03, 260.08.

The action provided by statute under Section 196.41 is by its nature an action in equity and has always been tried and dealt with as an equity cause. It has very recently been held that the provision in the Oregon statute for a suit "to vacate and set aside" an order

of the Commission (language identical with Section 196.41) does not prevent recourse to the federal court.

Pacific Northwest Public Service Co. v. *Thomas*, Statutory Court, Dist. of Oregon, July 25, 1932.

To the same effect are

Prendergast v. *N. Y. Tel. Co.*, 262 U. S. 43.

Railroad & Warehouse Comm. v. *Duluth Street Ry.*, 273 U. S. 625.

III.

Unity of Complainant's System and Lack of Compensation for Terminal Toll Service.

The complainant's telephone system consists of 96 exchanges furnishing local service and toll terminal service, and a state-wide network of toll lines connecting the exchanges (Comp. Aff., p. 38). These exchanges are located in different cities throughout the state and each exchange is inherently distinct from other exchanges except for the connection between them by the toll lines. There can be no possible justification for dealing with the rates in all 96 exchanges uniformly as a single system, except by including with them the service connecting them, namely, the toll.

The Commission's Order and Notice instituting its proceeding (Exhibit A to the Complaint) covers the "rates, charges, tolls, rules, services, practices and activities of the Wisconsin Telephone Company". That includes both exchange and toll. Toll Service between exchanges is paid for on a message basis; and the specific toll message fee covers the toll service from toll board to toll board. The essential point is that the terminal toll service covering the service from the toll board to the subscriber's station is included in the exchange rates. Whatever be the situation else-

where, this is the rate basis in Wisconsin established both by the company's own practice and its relations with connecting companies (Comp. Aff., p. 188) and also the orders of the defendant Commission (Comp. Aff., p. 104, Ex. F. Mo. #2, 3 and 4).

Rock County Farmers Tel. Co., 28 W. R. C. R. 47.

Marathon City Tel. Co., 29 W. R. C. R. 210.

Wisconsin Telephone Co.—Marinette Telephone Co., P. U. R. 1931A, 477, 478.

This is also the basis adopted in other states, including decisions in cases in which the affiant Hill (Def. Aff., p. 98) testified to segregation on a different theory.

Public Utilities Comm. v. *New England Tel. & Tel. Co.*, P. U. R. 1926O, 207, 261 (R. I.).

N. D. Bd. of Railroad Commrs. v. *Abercrombie Tel. Co.*, P. U. R. 1923*b*, 457, 472 (N. D.).

Tri-County Tel. Co. v. *Gandy Switchboard Co.*, P. U. R. 1920B, 760, 765 (Neb.).

See also:

Report of Special Master, Southwestern Bell Tel. Co. v. *City of San Antonio* (1932).

Ill. Bell Tel. Co. v. *Moynihan*, 38 Fed. (2nd) 77, 83.

The defendant Commission throughout, in its Order and its pleading, recognizes that exchange service includes both terminal and toll and local use, and it makes allocation of exchange property and expenses between toll and local use (Order, pp. 76-81, 89). It then proceeds to make *an order affecting not the complainant's revenue for local service alone, but the complainant's revenue for all exchange service, both local and toll terminal.* It seeks to justify this in its answer and supporting affidavits by allocating prop-

erty and expenses to local service alone and treating the entire exchange revenue as if it were for local service alone, an assumption that (as is practically admitted (Answer, p. 20)) would leave the toll terminal service without any revenue whatever. The Order, however, does not relieve the complainant from terminal toll service; the toll terminal service still remains a part of the exchange service, which the Order requires the complainant to render at rates computed to include no compensation for it. The Commission's intimation that toll rates are open for further consideration does not affect the situation; under the present Order, uncompensated service is being required, and the complainant's application for rehearing calling this to the attention of the Commission (pars. 37) was denied.

The Commission's Order on its face not only thus cuts off all compensation for intrastate toll terminal service, but also on its own hypothesis reduces the return on toll service to less than 1% of the investment therein. (See Commission's Order, page 89.)

It is unconstitutional to require traffic "to be carried at a loss or without substantial compensation over its proper cost even with respect to only a part of a company's business".

Banton v. *Belt Line Ry. Corp.*, 268 U. S. 413, 421.

A fundamental fallacy in the Commission's Order is the assumption that because separation of property revenues and expenses of the interstate toll service must be made in a rate case for the purpose of determining separately the intrastate property revenues and expenses, that such a division necessarily must be made between intrastate toll and local service. There is no reason why a single monthly charge should not be made for several kinds of service, such as is recognized even under the Commission's Order for

interstate and intrastate exchange service at Beloit and Hudson. Such a method of charge is a matter of management and within the power of the company.

See Master's Report, Southwestern Bell Tel. Co. v. *City of San Antonio.*

Southwestern Bell Tel Co. v. *Public Service Comm.*, 262 U. S. 276, 289.

Interstate Commerce Comm. v. *Chicago Gt. West. Ry.*, 209 U. S. 108, 118.

The Commission's Order further errs in assigning the entire exchange revenue to local service, disregarding the rule of the case of *Smith* v. *Ill. Bell Tel. Co.*, 282 U. S. 133, 148, that for rate purposes even as between interstate and intrastate there should be separation of the "property, *revenues* and expenses."

IV.

Impropriety of Return on Capital Stock as Rate Base.

The Commission's Order purports to judge the complainant's return, not by its relation to the complainant's investment or the value of its property, but by the amount of complainant's capital stock, the theory being that a return of 6 per cent on the capital stock is adequate. Even this basis is not applied to the company's entire capital stock, but merely to a portion thereof which the Commission computes to represent the part of the exchange property used for local service. This assumes that a vertical subdivision of the credit side of a balance sheet can be made by subdividing all the items thereof to various departments of the business. Neither law nor accounting practice justifies any such action. The Commission computes a margin of $288,000 above its computed 6 per cent return on the computed allocation of capital stock which

it infers will provide for reduced business in 1932 (Order, p. 100).

However, even making all the exclusions from operating expenses that the Commission makes, the return for the first six months of 1932 on the portion of the capital stock allocated by the Commission to local service with the proportion of surplus allocable thereto would be only 5.53% and this would still leave the terminal toll service entirely uncompensated, and the entire toll service earning less than 1 per cent on the capital stock allocated by the Commission thereto.

V.

8 Per Cent on the Property Used and Useful is a Reasonable Rate of Return.

A reasonable rate of return must be such as assures confidence in the financial soundness of the enterprise and be adequate under efficient and economical management to maintain the company's credit and enable it to raise the money it needs.

Bluefield Co. v. *Public Service Comm.*, 262 U. S. 679, 692.

United Railways v. *West*, 280 U. S. 234, 249.

Smith v. *Ill. Bell Tel. Co.*, 282 U. S. 133.

The rate of return must be tested by present-day conditions.

United Railways v. *West*, 280 U. S. 234.

Further, the return must be more than current interest on mere investment.

United Railways v. *West*, 280 U. S. 234.

And the return must be more than the yield on bonds, plus brokerage.

McCardle v. *Indianapolis Water Co.*, 272 U. S. 400, 419.

Further, the return, besides paying expenses and depreciation and reasonable dividends, must yield a surplus above it.

United Railways v. *West*, 280 U. S. 234, 251.

The affidavits of Sunny (Comp. Aff., p. 133) and Baird (Comp. Aff., p. 139) and Hoyt (Comp. Aff., p. 145) all show that an 8 per cent return on the fair value of property used and useful in the business is necessary at the present time and under present circumstances. Mr. Baird (Comp. Aff., p. 141) shows that in 1931 and the first six months of 1932 the stocks of soundly managed public utilities sold at their highest price on a basis of earnings of from 7.19 per cent to 8.53 per cent and at their lowest price at a basis of from 12.68 per cent to 21.30 per cent; and that companies whose average earnings for five years yielded from 7.33 per cent to 10.05 per cent return on the invested capital were able to sell their bonds on a basis ranging from 5.4 per cent to 9.5 per cent per annum. Sunny and Hoyt expressly state that they took into consideration the relations of the complainant to the American Telephone & Telegraph Company (Comp. Aff., pp. 137, 149).

The affidavits of the Commission in no way tend to contradict this need of an 8 per cent return. Mr. Morehouse's affidavit (Def. Aff., p. 123) shows that for the ten-year period the earnings of the Wisconsin Telephone Company were 6.30 per cent on its assets and the return of other Bell operating companies averaged less than 6 per cent, but the statement as to other Bell operating companies does not indicate the status or financial weight given the American Telephone & Telegraph Company. The sustaining of credit necessarily rested on the public's faith in increased earnings. Further, these earnings were during periods of substantially different credit conditions and financial

situation from the present time. The rates fixed by a commission are maxima, beyond which the company cannot rise; and to require a company to earn less than 8 per cent even if its business is capable of yielding that amount, necessarily must impair its credit and make it impossible for the company to finance itself on a 7 per cent, much less on 6 per cent or a less rate of earnings.

Mr. Mathews' affidavit (Def. Aff., p. 126) indicates that he thinks $5,000,000 of bonds could be issued annually for three years at a basis of an approximately 6 per cent yield, even if the complainant were earning only 4 per cent per annum; but it must be noted that this would be an approximate 6 per cent yield on bonds having behind them an equity of $45,000,000 in preferred and common stock—that is, a bond issue with 400 per cent of security, and even then the bond issue would be issued only over a period of three years.

The clearest light on present conditions is that the complainant's 7 per cent cumulative preferred stock, having behind it an equity in common stock and surplus of over 9½ times the preferred stock issue, is selling at approximately par—that is, about a 7 per cent yield. Obviously the return of the common stock must be very materially greater.

The most recent decision of a Statutory Court in the case of *Tri-State Telephone & Telegraph Co.* v. *Attorney General, et al.*, decided September 14, 1932, held that a return below 7 per cent would be confiscatory.

The Supreme Court of Wisconsin has repeatedly held a return of 7½ per cent a reasonable return for public utilities.

Duluth Street Ry. Co. v. *Railroad Comm.*, 161 Wis. 245, 247.

Smith v. *Railroad Comm.*, 169 Wis. 547.

T. M. E. R. & L. Co. v. *Railroad Comm.*, 169 Wis. 421, 428.

In *Wisconsin-Minnesota Light & Pr. Co.* v. *Railroad Comm.*, 183 Wis. 104, 105, the court without comment followed the Commission's basis of an 8 per cent return, and in *Pabst Corp.* v. *Railroad Comm.*, 199 Wis. 536, the court likewise upheld an 8 per cent return for the Milwaukee municipal water works.

VI.

Rates of Return.

The following represents a summary of the complainant's several computations of rates of return as contained in the bill of complaint and the affidavits.

Computations of Rates of Return.

For the Year 1931

	Property (Average)	Present Rates		Proposed Rates	
		Net income	Rate of return	Net income	Rate of return
Interstate and Intrastate:					
Entire telephone service:					
Investment	81,135,066*	2,891,481	3.0%	1,663,583*	2.1%
Fair value	76,066,979*	2,891,481	3.9%	1,663,583*	2.2%
Entire exchange service:					
Investment	59,863,570*	2,331,571	3.9%	1,053,955*	1.8%
Fair value	55,895,026*	2,331,571	4.2%	1,053,955*	1.9%
Entire local service (with actual expenses):					
Investment	54,251,434	2,265,740	4.176%	1,025,006	1.889%
Fair value	50,755,065	2,265,740	4.464%	1,025,006	2.02%
Intrastate:					
Intrastate telephone service:					
Investment	73,588,891	2,582,110	3.51%	1,319,874	1.95%
Fair value	68,757,563	2,582,110	3.76%	1,319,874	2.08%
Intrastate exchange service:					
Investment	58,210,268	2,301,679	3.95%	1,035,000	1.73%
Fair value	54,202,856	2,301,679	4.25%	1,035,000	1.86%
Intrastate local service (with actual expenses):					
Investment	54,051,971	2,250,261	4.163%	1,011,145	1.871%
Fair value	50,503,299	2,250,261	4.450%	1,011,145	2.002%

* Subject to trifling correction—See pp. 87 and 61 of Complainant's affidavits.

Computations of Rates of Return.

For the First Six Months of 1932

	Property (Average)	Present Rates		Proposed Rates	
		Net income	Rate of return (Annual basis)	Net income	Rate of return (Annual basis)
Interstate and Intrastate:					
Entire telephone service:					
Investment	84,292,841	1,226,494	2.91%	606,327	1.44%
Fair value	78,604,828	1,226,494	3.12%	606,327	1.54%
Entire exchange service:					
Investment	62,090,824	1,137,451	3.66%	500,198	1.61%
Fair value	57,572,812	1,137,451	3.95%	500,198	1.74%
Entire local service (with actual expenses):					
Investment	56,290,097	1,125,559	3.999%	513,705	1.825%
Fair value	52,491,687	1,125,559	4.289%	513,705	1.957%
Intrastate:					
Intrastate telephone service:					
Investment	76,584,685	1,169,886	3.06%	546,550	1.43%
Fair value	71,381,459	1,169,886	3.28%	546,550	1.53%
Intrastate exchange service:					
Investment	60,327,134	1,127,201	3.74%	490,553	1.63%
Fair value	55,957,759	1,127,201	4.03%	490,553	1.75%
Intrastate local service (with actual expenses):					
Investment	56,033,858	1,117,948	3.99%	506,708	1.809%
Fair value	52,252,773	1,117,948	4.279%	506,708	1.939%

VII.

Valuation of Complainant's Plant.

A.

Principles of Valuation.

It is well recognized that the fair value of the property used and useful in rendering service is the proper basis for consideration in determining whether or not a rate of return is confiscatory. Fair value is a concept in which reproduction cost new, less actual existing depreciation, is the predominant feature, but nevertheless weight must be given to the investment in property.

McCardle v. *Indianapolis Water Company*, 272 U. S. 400 (415).

Bluefield Water Works & Improvement Company v. *Public Service Commission of West Virginia*, 262 U. S. 679 (689).

Southwestern Bell Telephone Company v. *Public Service Commission*, 262 U. S. 276.

Pabst Corp. v. *Railroad Commission*, 199 Wis. 536 (540).

Here there is not a great deal of difference between cost of reproduction new before depreciation allowance and investment before such allowance. The reproduction cost new of and the investment in tangible property of the complainant (excluding materials and supplies, working capital and going value) on July 1, 1932, as stated by affiant Crowell was respectively $75,628,658 and $76,461,038 (Exhibit G. F. C. #1 of Complainant's Affidavits). The average reproduction cost new in 1931, as estimated by affiant Hill was $73,349,078 (Def. Aff., p. 106), which estimate is exclusive of the value of general equipment on the one hand, but

which on the other hand, in the opinion of the affiant, requires reduction to allow for alleged piece-meal construction.

B.

Methods Used in Complainant's Valuation.

1.

Plant Measurement Records.

Complainant's engineer Crowell, in determining reproduction cost of complainant's "outside plant", applied various prices, hereinafter discussed, to quantities of each kind of complainant's property as shown by complainant's plant measurement records. These records are maintained currently by complainant's Accounting Department by additions and subtractions as additions and retirements occur in the plant. They are used in current operations and are subject to continual check (Comp. Aff., pp. 90, 91). Frequently occasion arises for checking the accuracy of those records in connection with partial inventories of property, depreciation studies, studies to determine displacement unit cost and to subdivide the property records (Comp. Aff., pp. 48, 49). The said plant measurement records were started in 1914, at which time a detailed physical inventory was available covering the Milwaukee exchange plant. In 1920, all the quantities were adjusted based upon checks of engineering records and conditions in the field (Comp. Rep. Aff., p. 159). The records of the complainant, as well as similar records of other Bell telephone companies, are substantially accurate and such minor inaccuracies as may exist are as likely to be an understatement of quantities as an overstatement (Comp. Rep. Aff., p. 170).

For the purpose of further substantiating the accuracy of these records, special studies have been made and presented herein by which quantities shown

by these records were compared with quantities drawn from blue-prints and other engineering records recently made in the field. A sample which involved about 62% on an investment basis showed the quantities in the field to be 101.7% of the quantities in the records (Comp. Rep. Aff., p. 161). Defendants claim inaccuracies in these records based on tests of a similar kind of a very much smaller sample (Def. Aff., p. 105 and Def. Rep. Aff., p. 17). Even the defendants' figures show only an alleged overstatement of approximately 10% for their entire study on an inadequate sample.

2.

Labor Prices.

In determining reproduction cost new of outside plant, complainant has used labor unit developed from 1927 studies for the reason that their use results in a lower valuation than with the application of 1932 wage rates of the complainant, even though complainant's 1932 wage rates for common or unskilled labor are lower than those currently paid by the City of Milwaukee in connection with its telephone plant (Comp. Aff., p. 51). A study made by an independent engineer for the complainant in order to verify these facts has disclosed that the 1927 labor units were reasonably representative of conditions experienced by the complainant during the years 1925 to 1930, inclusive, and were substantially lower than rates in 1932 or the intervening period (Comp. Aff., p. 114). Defendants' engineer has also determined that 1930 and 1931 rates per productive labor hour were very much higher than previous years (Def. Aff., p. 107).

On classes of property other than outside plant, current labor rates are embraced in the indices applied to building and central office equipment. A special labor price was applied to station installation (Comp.

Aff., p. 55) and the remaining classes of equipment did not require a separate determination of labor rates or units (Comp. Aff., p. 51). It is apparent that complainant's reproduction cost new reflects labor rates that are lower than would have to be paid currently.

3.

Material Prices and Indices.

In complainant's determinations of reproduction cost new, the general method used was to apply prices covering the components of the property to the quantities on hand on January 1, 1932 and July 1, 1932. These prices were determined by means of indices supplied in a publication known as the "Price Trend Review" and also by indices furnished by the plant engineer of American Telephone & Telegraph Company (Comp. Aff., p. 50). The sources and accuracy of these indices are separately substantiated by the affidavit of E. V. Cox who prepared them from time to time (Comp. Aff., p. 65) to which affidavit the volume of said Price Trend Review and the list of indices which were used are appended as exhibits (Comp. Ex., pp. 6-9). The application of these indices to the complainant's quantities of property was separately studied by Maynard A. Cook, a consulting engineer, and his conclusion thereon that the complainant's determination of reproduction cost new was reasonable, sound and conservative and that complainant has resolved every doubt in favor of the lower valuation is contained in his affidavit (Comp. Aff., pp. 113 to 118, incl.).

The valuation of buildings was made by the complainant on a cubic foot basis, using indices developed from the Engineering News Record (Comp. Aff., pp. 51, 52). Complainant caused the buildings to be independently appraised during the month of August, 1932, as of July 1, 1932, by American Appraisal Com-

pany. The valuation (both reproduction cost new and reproduction cost new less depreciation) thus determined was somewhat higher than that which complainant has used in its computations herein (Comp. Aff., p. 130).

Defendants have called attention to the fact that most of the purchases of the complainant are made from Western Electric Company and most of the said price indices are largely based on articles manufactured by Western Electric Company, which is an affiliate company. Complainant contends that, if this were not a fact, its valuations would necessarily be higher. A study of the complainant's purchases in the past twelve years, as made by said E. V. Cox, shows that it has saved on an average of at least 15 per cent by purchasing apparatus manufactured by Western Electric Company and an average of 8 per cent by purchasing other supplies through Western Electric Company (Comp. Aff., p. 70). Complainant's affidavits also demonstrate that Western Electric Company in the past sixteen years has earned from its sales to Bell companies (including the complainant) an average profit of 6.6 per cent on its investment, while the average return of 88 similar companies was 12.2 per cent and that the profit of Western Electric Company on such sales was less than in the case of 32 out of the 38 companies as to whom sales data was available (Comp. Aff., p. 221). Complainant also shows that all prices charged by Western Electric Company to its affiliated customers during the past ten years have been and now are substantially lower than the prices charged by other manufacturers or suppliers (Comp. Aff., p. 208).

Defendants have suggested in their affidavits that recent prices of Western Electric Company have not followed the general downward trend of prices (Def. Aff., p. 117). General reductions in prices of Western Electric Company considerably preceded the general

downward trend and between 1921 and November, 1930, the whole reduction of Western Electric prices was 40 per cent so that, if the 1930 purchases of the complainant had been made at 1921 prices, the cost would have been 60 per cent higher than it was. In November, 1930, there was a price increase by Western Electric Company of about 9 per cent on its previously reduced prices (Comp. Aff., p. 226). The trend of general prices downward has been halted and there are definite signs of an upward trend (Comp. Aff., p. 119).

4.

Effect Given to Piece-meal Construction.

Complainant's plant was, of course, built by a series of additions over a long period of years and it is, of course, recognized that this condition results in a somewhat higher cost than would unit reproduction. This condition has been considered and allowed for in complainant's determination of reproduction cost new (Comp. Aff., pp. 49, 54, 162). In the case of central office equipment, which is the largest single class of property from an investment standpoint, a discount of 17 per cent has been deducted as a specific allowance for this condition (Comp. Aff., p. 54), and throughout the whole determination of value, it has been given recognition along with other general conditions, such as the length of time required for building and assumed availability of complainant's trained personnel. Moreover, complainant has made its valuation on the assumption that the expensive cutting into pavements, streets and highways, which is avoided under complainant's regular practice, as far as practicable, by installations in advance of paving, would be true on reproduction, which is, of course, improbable (Comp. Aff., p. 49).

5.

Prices Under Normal Conditions and for Period of Building.

Complainant's valuation has been based on July 1, 1932, price basis (Comp. Aff., p. 50). The period required for reproduction would be four to five years and this was independently verified by M. A. Cook, consulting engineer, who estimated the same at five years (Comp. Aff., pp. 58, 119). The valuation which has been used is believed to be lower than would be realized if the plant were constructed in the five-year period just concluded or in the five-year period just commencing (Comp. Aff., p. 58).

The proper rule in the determination of reconstruction cost new is to base prices upon those which would prevail over the period of time required for rebuilding of plant, based as far as possible on a similar period in the past.

Public Utility Com'rs. v. *Elizabethtown Water Co.*, 43 Fed. (2d) 478, 483.

City of Redding, P. U. R. 1919F. 415, 423.

It is also proper in making valuations to ignore temporarily distressed or inflated prices and base valuations on normal conditions. Of course, full effect has been given by complainant to the price declines which have occurred and the only elements which have been excluded are the temporarily distressed conditions which have led some contractors and others to work without profits, which is a situation that could not be applicable to any extensive building period. (Comp. Aff., pp. 58, 130.)

Greencastle Water Works Co. v. *Commission*, 31 Fed. (2d) 600.

Pacific Telephone & Telegraph Co. v. *Whitcomb*, 12 Fed. (2d) 279.

Brooklyn Borough Gas Co. v. *Commission*, P. U. R. 1918F. 335.
McCardle v. *Indianapolis Water Co.*, 272 U. S. 400.
Re City of Redding, P. U. R. 1919F. 415, 423.
Consolidated Gas v. *Newton*, 267 Fed. 231.
Reno Pr. Light & Water Co. v. *Public Service Comm.*, 300 Fed. 645.
Galveston Electric Co. v. *Galveston*, 272 Fed. 147.

6.

Physical Condition of Property.

In determining a valuation based on cost of reproduction new, less depreciation, complainant determined the actual physical condition of the property by consideration of each class thereof, the composite effect of this computation being a reduction of 7.3 per cent for actual existing depreciation of the plant as a whole. This may be stated as a "per cent condition" of 92.7 per cent (Comp. Aff., p. 58). The actual condition of the buildings was further examined by American Appraisal Company and its independent conclusion is that the condition of the buildings is somewhat better than that determined by complainant (Comp. Aff., p. 130). The determination of actual existing depreciation for all of the rest of the property has been verified by Mr. William F. Sloan, a consulting engineer of great experience with reference to telephone plants, and a crew of engineers under his direction. They actually examined over 50 per cent of complainant's property and, as a result, determined that the "per cent condition" was 90.7 per cent or 2 per cent less than complainant has used (Comp. Aff., pp. 124, 125). The amount to be deducted is the amount which reflects actual physical wear and tear, as the complainant has here deducted

such amount from its determination of reconstruction cost new.

McCardle v. *Indianapolis Water Co.*, 272 U. S. 400, 415.

Pacific Telephone & Telegraph Co. v. *Whitcomb*, 12 Fed. (2d) 279.

Minnesota Rate Cases, 230 U. S. 352, 457.

Southern Bell Tel. & Tel. Co. v. *Railroad Comm.*, 5 Fed. (2d) 77, 96.

C.

Investment in Property.

1.

Sources.

Complainant's investment in property has been taken from its books of account and included in its affidavits, both as to exchange plants and equipment and as to toll plant and equipment. Allocations of the same to intrastate and interstate service and the local service have been made according to methods hereinafter described (Comp. Aff., pp. 73 to 91, 117, Ex. G. F. C. #1). In addition, complainant's balance sheet as of July 1, 1932, and its earning statement for the first six months of 1932, have been presented (Ex. E. A. F. #1 and Ex. E. A. F. #2).

2.

Complainant's Book Depreciation Reserve.

Complainant's depreciation reserve is maintained as a single fund to cover all of its plant and property and is a reserve designed to provide for physical wear and tear which has already occurred and also for retirements and losses which may occur from obsoles-

cence, inadequacies, public requirements, extraordinary repairs and all ordinary casualties which may occur in the future, with the exception only of partial fire insurance coverage.

This method is in accordance with rules prescribed by the Interstate Commerce Commission and approved by the defendant Commission. The various elements contained in the reserve for future contingencies are indivisible on any sound theory from the element in the reserve designed to cover physical wear and tear which has already occurred (Comp. Aff., p. 173).

Under the law, the depreciation reserve of a public utility is the property of the utility and is not to be deducted in determining the investment in the property.

Public Utility Commission v. *Capital Traction Co.*, 17 Fed. (2d) 673, 676.

Board of Public Utility Commissioners v. *New York Telephone Company*, 271 U. S. 23, 31, 32.

D.

Considerations Affecting Valuations on Both Reproduction and Investment Bases.

1.

The Actual Plant and not the Ideal Plant is to be Considered.

All of complainant's property is used and useful in its telephone business. As in any public utility located in growing communities, there is necessarily provided a certain amount of physical facilities somewhat in advance of their actual entrance into service. For the first time in many years of experience, complainant has recently suffered a loss in subscriber stations, although this has been limited to about 5 per cent up to July 1, 1932.

Property to take care of reasonable expansion and plant temporarily unused are properly included in complainant's property used and useful for its business.

Consolidated Gas Company v. *Newton*, 267 Fed. 231.

Pacific Telephone & Telegraph Co. v. *Whitcomb*, 12 Fed. (2d) 279, 288.

Brooklyn B. Gas Company v. *Prendergast*, 16 Fed. (2d) 615, affirmed 276 U. S. 671.

It has been held that even where a utility was located in a community of declining population, it was not required to eliminate, from its property, the amount representing its unused plant.

Ashland Water Company v. *Commission*, 7 Fed. (2d) 924, 935.

As was stated in *Natural Gas Company* v. *Commission*, 121 S. E. 716 (722) it is the particular plant involved in this case and in the present location, surroundings and local conditions as to which reproduction cost now is sought and not as to an ideal plant.

2.

Determination of Going Value.

Complainant has used 10 per cent of its reproduction cost new on July 1, 1932, as the proper amount of going value (Comp. Aff., p. 57). This amount is less than is recommended for this purpose by some engineers (Comp. Aff., pp. 117, 118) and has been approved by Federal courts.

McCardle v. *Indianapolis Water Co.*, 272 U. S. 400, 415.

Columbus Gas & Fuel Company v. *Columbus*, 17 Fed. (2d) 630, 635.

3.

Valuation of Working Capital and Also Materials and Supplies.

Complainant has taken for its valuation of working capital an amount equal to 1 per cent of its investment in plant and equipment on July 1, 1932, which is approximately the same as the amount of cash required for one month's operating expenses (Comp. Aff., p. 57). It has taken as its materials and supplies $436,813 which is the actual investment therein on July 1, 1932. As stated in the affidavits, this investment includes $85,766 covering equipment recently retired from service and carried at salvage values and $113,100 representing motor vehicle equipment in storage. As hereinbefore stated, these two items are proper components of complainant's property, whether or not they are properly classified as materials and supplies. The amount, therefore, actually included as materials and supplies is the book investment of $237,947 (Comp. Aff., p. 56, 57).

Maynard A. Cook, a consulting engineer of considerable experience in making valuations of telephone plants throughout the United States, has independently studied the amount which complainant has included for working capital, materials and supplies, considered together and by his own methods has determined that complainant would be justified in an inclusion of $200,000 more than it has included and also that even larger amounts might be claimed under approved methods (Comp. Aff., p. 117).

4.

Interest During Construction.

Complainant has determined the valuation to be included for interest during construction at 6 per cent of

the reconstruction cost new as of July 1, 1932 of plant and equipment (Comp. Aff., p. 56). Said affiant Cook states that the customary practice of computing the interest on the basis of an actual study of the amounts of money required and the periods for which required during the course of five years' construction work would require a large amount of time and that from his examination of the case, it is his opinion that it would not produce a result substantially different from that reached by complainant in the time available for study of this item (Comp. Aff., p. 117).

In a reply affidavit, defendants' engineer Hill concludes that 4 per cent instead of 6 per cent is a proper allowance for interest during construction (Def. Rep. Aff., p. 18) based on his Exhibit C. G. H. No. 1 by which he presents date as to the computation of this item in connection with an appraisal of the property of the New York Telephone Company outside of New York City in 1924. It is submitted that the conditions of reproducing that property at that time are not comparable with the conditions of reproducing the complainant's property in 1932.

E.

Allocations of Property.

Complainant's books classify property among telephone services only into toll plant and equipment and exchange plants and equipment. The exchange service embraces both local calls and toll terminal calls, *i. e.*, handling toll calls between the toll switchboard and the subscriber station. The toll service embraces handling toll calls between toll switchboards. Exchange service is largely intrastate and it embraces local service to a few subscribers in northern Illinois and eastern Minnesota and the exchange at Hurley, Wisconsin, where all business is routed through Michi-

gan and also embraces toll terminal service on intrastate as well as interstate toll calls. A majority of the toll business is intrastate, although there is substantial interstate portion (Comp. Aff., p. 79). *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133, indicates the need for segregations of property, revenue and expense between interstate and intrastate business (Comp. Aff., pp. 80 to 87, 93 to 99). The methods used have been set out in great detail in complainant's affidavits. In general, they are based on traffic studies.

Through these allocations, complainant is in a position to present complete data on the rate of return for the following classes of business: entire service, entire exchange service, entire intrastate service, exchange intrastate service, entire local service and intrastate local service. For each of these classes, data is presented as to the rate of return in 1931 and in 1932, under present telephone rates and under the proposed reduction of rates and in relation to investment in property and fair value of property (which in this case is cost of reproduction new, less depreciation).

VIII.

Revenues.

A.

Allocation.

The revenues of complainant are taken from its books and the amount is not at issue, the only question being with reference to allocation. Complainant's revenues are classified on its books as exchange and toll revenues. These have been duly allocated to intrastate and interstate business, respectively, and in addition an allocation of exchange revenues has been made between local service and toll terminal service only to accompany and complete defendant's claimed

allocation of expenses and property between these services and to avoid the result admitted by the defendants of providing no revenue from any source for complainant's toll service.

B.

Application of Commission's Reduction.

The reduction in complainant's rates, which is sought to be enjoined here, has been applied in some of complainant's computations. Complainant has recognized that this reduction in rates will result in a diminution of most of its tax payments and its license payments, which are measured by its gross or net income. In determining its net income for purpose of computing its rates of return, where complainant has reduced revenues in its computations, it has also proportionately reduced its taxes and license payments. Complainant allocates its taxes between toll and exchange expense according to gross revenues and this fact resulted in reflecting some tax-saving in its toll net income, even though the reduction in revenues was limited to exchange revenues (Comp. Aff., p. 175). This fact, which is noted by defendants as an indication of inaccuracy (Def. Aff., p. 101) is in fact an evidence of the consistency and care exercised by the complainant in its computations.

IX.

Expenses.

A.

Allocation of Expenses.

Complainant's computations as to income in 1931 and 1932 are based upon its actual expenses, except in one instance, (separately presented from those herein)

where in order to demonstrate that confiscation would still follow, even if the defendants' erroneous criticisms of complainants expenses were valid, complainant has used the reduced expense basis. In allocation of expenses between intra- and interstate service, complainant has largely depended upon traffic studies or the allocation of the property from which the expenses are derived. In allocations of exchange expenses between local and terminal toll service, the complainant has followed the allocations asserted by the defendant Commission, without agreeing therewith (Comp. Aff., pp. 84 and 85, 179-180).

B.

Criticisms of Complainant's Expenses.

In defendants' computations, they have used as expenses, amounts which are less than complainant's actual expenses in the case of four classes, to-wit: maintenance, depreciation, employees' benefit and pension expense, and license payments.

1.

Maintenance.

The defendants have determined the amount of maintenance expense which they believe complainant should have on the basis of complainant's actual maintenance expense in 1928, which was $6.35 per station. As a matter of fact, complainant's actual maintenance expense for the first seven months of 1932 was $7.80 (Comp. Aff., p. 182).

One of the elements of maintenance expense which defendants suggest could be reduced is that growing out of the conversion of manual equipment into automatic or dial equipment. The actual expense of such conversion is of course capitalized, but as the parties agree, there is some additional maintenance expense

resulting from the actual conversion. As a matter of fact, the operation of converting a telephone exchange or office to the dial system involves several years of planning and more than a year of actual field work. The work is handled on a ten-year program, and sudden abandonment would be wasteful and extravagant (Comp. Aff., pp. 29, 163). The maintenance expense of dial equipment is greater per station than the maintenance expense of manual equipment, after conversion is completed and the equipment is in use, although there are greater savings in other departments. Although defendants recognize this fact in words (Def. Aff., p. 112), the demanded use of 1928 maintenance levels for the year 1932 results in ignoring this factor of increased maintenance in defendants' computations, although the dial conversion program started in 1928, and there are now a substantial number of such installations (Comp. Aff., p. 163).

In 1926, complainant inaugurated preventive maintenance practices, involving periodic inspections of portions of the plant, and repair thereof prior to wear and tear being permitted to cause an actual break in service. Naturally, preventive maintenance results during the first years of the practice in some increased maintenance expense. This practice has had very beneficial effects on complainant's service, and has resulted in reducing troubles per hundred average stations per year from 70.26% to 47.70% (considering troubles from switchboard to the subscriber station). It also resulted in an increase in the average length of time which a telephone operates without a break in service from 17 months to 25 months. The practice has been inaugurated gradually and is in use to a much greater extent in 1932 than was true of 1928 (Comp. Aff., p. 60). Nevertheless, this factor in complainant's management has been ignored by the defendants in using 1928 levels for maintenance.

In a reply affidavit, defendants' engineer Hill has set forth some figures relative to subscribers' trouble reports (Def. Rep. Aff., p. 25). Obviously the reports made by subscribers of troubles, which they have noted and which may or may not be maintenance and property troubles, are not as sound a basis for studying maintenance practice as are the reports of actual property troubles, which complainant uses.

2.

Depreciation.

Defendants have criticized and in their computations have reduced complainant's depreciation expense on account of the rates of depreciation which complainant considered in its composite rate on account of the components of its property consisting of central office equipment, station apparatus, private branch exchange property, and booths and special fittings. Defendants have stated their criticism of this expense in detail (Def. Aff., pp. 89, 92). These criticisms and conclusions of the defendant are taken up and controverted in equal detail by complainant (Comp. Aff., pp. 61 and 64, incl., and 165 to 167, incl.).

Another issue between the parties relative to depreciation relates to the fundamental theory. As stated, the complainant regards its depreciation reserve as an entity to provide indivisbly for existing wear and tear and for stated future contingencies in accordance with the rules of the Interstate Commerce Commission (Comp. Aff., p. 88). Defendants undertake to break down this depreciation reserve through the work of affiant Colbert on a historical basis, analyzing the debits and credits to the account over a period of nearly forty years, and assigning all the reserve, ignoring the contingent or insurance factors therein,

to classes of property (Def. Aff., p. 69). Complainant maintains that there is no basis in existence for a correct historical breakdown, since for a third of the period covered by this study of Colbert, additions to the reserve were made without regard to property classes, and because the charges to the reserve on account of extraordinary repairs and other casualties embrace both depreciable and non-depreciable property (Comp. Aff., p. 173). In order to produce amounts which said Colbert claims are portions of the reserve allocated to property, in the face of the difficulties mentioned, said Colbert has had to give to data obtained from the complainant, a use and significance inconsistent with complainant's purpose or use thereof, and make applications of figures in a manner which required many arbitrary and highly controversial assumptions and decisions on the part of said Colbert. In addition, more than one hundred errors were determined to exist in his work (Def. Aff., p. 69; Comp. Aff., pp. 172-3).

The element of the complainant's depreciation reserve which is provided for physical wear and tear, is designed to cover the whole of complainant's plant on an average basis. The comparison of parts of an average with specific constituents is unsound.

The erroneousness of the historical method used by Colbert in breaking down the reserve is well demonstrated in the fact that the defendants allocate complainant's property to local use as 66.2% of the whole, whereas on the allocations of portions of the reserve as determined by said Colbert to local property as made by the defendants, 80.6% of complainant's depreciation reserve is allocated (Comp. Aff., p. 175).

As defendants state, the Interstate Commerce Commission has ordered that at a future date the depreciation reserve of telephone companies be broken down to

classes of plant. Complainant interprets this order as requiring the breakdown to be in accordance with the actual and existing depreciation determinable in the plant at the date of the study based on the character of the plant as it then exists (Comp. Aff., p. 167), while said Colbert interprets it as requiring the impossible historical breakdown which he has purported to make (Def. Aff., p. 94).

3.

Employees' Benefit and Pension Payments.

Defendants claim that a portion of complainant's expense on account of employees' pension and benefit payments should be charged to construction and therefore not to expense. Complainant charges all of this item to expense in accordance with the specific instructions of the Interstate Commerce Commission (Exhibit E. A. F. #9). Moreover, it believes that this method is the more conservative and sound for the reasons set forth in detail in its affidavits (pp. 183-4). Although the defendants have eliminated a portion of this expense from complainant's actual expenses in their computations, they have not added it to complainant's property, which should be done on the defendant's theory.

4.

License Payments.

Defendants make a similar claim that a portion of complainant's expense for license payments should be charged to construction and eliminated from expense. Complainant also charged this item entirely to expense in accordance with the requirements of the Interstate Commerce Commission (Exhibit E. A. F. #10, Comp. Aff. p. 90), and agree with this require-

ment of the Interstate Commerce Commission for similar reasons of soundness and conservatism (Aff., p. 184). Here also the defendants have eliminated this item from expense and have not made the addition to property which their theory requires.

The question of capitalizing amounts paid by a telephone company to American Telephone & Telegraph Company under a license contract like that here in question has been squarely presented to and rejected by the courts.

City of Cincinnati v. *P. U. Com.*, 148 N. E. 817 (827).
City of Huntington v. *P. S. Com.*, 133 S. E., 144 (148).

Defendants claim that these payments are extravagant. The affidavit of Charles A. Heiss, Comptroller of American Telephone & Telegraph Company, sets forth in full details the nature and value of the services received for license payments, together with a complete organization chart of American Telephone & Telegraph Company, showing all its affiliations, and copies of the contracts between the complainant and said Company. The said affiant further shows that the American Company has lost over $11,000,000 in furnishing this service for the year 1931, and is losing at nearly the same rate for 1932 (Comp. Aff., pp. 197 to 206, inc.).

C.

Management Powers and Interference Therewith

In all of the adjustments of expenses which defendants have erroneously made, and particularly in the adjustment of maintenance expense, the defendants have ignored the settled rule of law that the Commission "is not the owner of the property of public utili-

ties companies, and is not clothed with the general power of management incident to ownership," and further that the Commission "cannot ignore items charged by the utility as operating expenses unless there is an abuse of discretion in that regard by the corporate officers."

Southwestern Bell Telephone Co. v. *Public Service Com.*, 262 U. S. 276 (289).

Pacific Tel. & Tel. Co. v. *Whitcomb*, 12 Fed. (2) 279 (288).

Eastern Wis. R. & L. v. *Hackett*, 135 Wis., 464, 485.

D.

Falling Revenues and Falling Expenses.

It is undisputed that the complainant's revenues in 1932 are declining. However, the defendants allege that complainant's expenses are also declining. It is a fact that over 85 per cent of defendants' expenses are for wages, salaries, rent, depreciation and taxes (Comp. Aff., p. 35). As to wages, there has been no decline (p. 51). Rent is a matter of contract; depreciation is obviously unaffected by temporary business conditions, and judicial notice may be invoked of the fact that taxes have not declined.

On the other hand, in the defendants' computations there is nowhere an allowance for the fact that complainant's expenses on account of uncollectible revenue, *i. e.*, bad debts, in 1932 will exceed the expense for 1931 by over $100,000 (Comp. Aff., p. 35), nor is there allowance for the fact that the expenses of the investigation by the defendant Commission to be paid to or which are claimed by it on account of its own chargeable expenses and without regard to complainant's direct expenses for such investigation, or com-

plainant's expenses in this litigation, will exceed $100,000 in the year 1932, as compared to 1931, when there were no such expenses.

X.

Value of Service and Loss in Stations.

It is alleged by the defendants that the loss of subscriber stations in recent periods indicate that the present rates of the complainant exceed the value of the service to large numbers of its subscribers (Def. Aff., p. 123). The fact is that from complainant's high point in number of subscribers which occurred in May, 1931, there has been a total loss up to June 30, 1932, of 5.15 per cent, which under present economic conditions complainant considers to be an excellent showing for the value of its service to its subscribers as compared with its rates. In June of 1932, 7838 stations were discontinued. Complainant caused an investigation to be made, in which each customer was questioned as to his reasons for discontinuance. Of this number, 22 or three-tenths of 1 per cent were attributed by the subscribers to dissatisfaction with complainant's rates. The remainder were attributed to other causes as is set forth in greater detail in complainant's affidavits (p. 189).

Defendants have suggested that the value of complainant's service to its subscribers is a necessary factor in determining rates for service. An examination of leading cases where this factor has been mentioned at all shows that it is considered by the courts as important only in cases where there is claim that the utility's costs are excessive due to over-capitalization and excessive bonded indebtedness; conditions which cannot be successfully claimed to exist as to the complainant.

XI.

There was no Jurisdiction to Reduce Complainant's Return.

The Wisconsin statutes make it a prerequisite o the reduction of rates by the Public Service Commis sion that the existing rates be found to be "unjust o unreasonable."

Wis. State. 196.37.

It is the Wisconsin law that the test of a reasonabl rate is a reasonable return to the utility.

Duluth Street Ry. Co. v. *Railroad Comm.*, 16 Wis. 245, 261.

A reasonable rate must be distinguished from a con fiscatory rate. A reasonable rate is something above bare confiscatory rate.

Waukesha Gas & Elec. Co. v. *Railroad Comm* 181 Wis. 281, 291.

Further, it is the Wisconsin rule that there shoul be a margin between a fair return on the company' property and its revenue; and the court has pointe out that it is only when this margin exists that reduc tion in rates "can ordinarily be ordered or enforced b the Commission."

M., St. P. & S. S. M. R. Co. v. *Railroad Comm* 136 Wis. 146, 167.

In the case at bar, the existing rates were not un reasonable, and the Commission therefore has no juris diction to order a rate reduction. This consideration i not affected by the fact that the Commission's Orde was designated as a temporary order or as an emer gency order. There is no exception in the statute wit respect to emergency or temporary orders, in thi respect.

XII.

Temporary Character of the Order no Justification.

The Commission attempts to sustain its order as temporary. But the fact that an order is temporary or that the Commission has reserved the right to modify the order does not change the complainant's right to be free from confiscation. The Supreme Court has expressly ruled that the fact that a rate is experimental does not justify a confiscatory low rate during the period of experimentation.

Northern Pac. Railroad Co. v. *Dept. of Public Works*, 268 U. S. 39, 41.

Prendergast v. *New York Tel. Co.*, 262 U. S. 43, 49.

Indiana General Service Co. v. *McCardle*, Statutory Court S. Dist. of Ind. July, 1932.

The Commission refers to certain rent cases (*Block* v. *Hirsh*, 256 U. S. 135; *Levy Leasing Co.* v. *Siegel*, 258 U. S. 242). These cases hold that war conditions justified the legislature in treating the renting of certain urban real estate as a business affected with the public interest, but the court expressly points out (256 U. S. 157) that "machinery is provided to secure to the landlord a reasonable rent."

The Commission throws great weight on the statement that the complainant may make application to the Commission at any time for a change of the temporary order. It is apparent, however, that such modification would have to be based on changed conditions, and not on the facts existing when the Commission's Order was made on June 30.

The law does not contemplate a new application to the Commission to rescind an order based upon the same state of facts as the original order.

C., St. P. M. & C. R. Co. v. *Railroad Comm.*, 178 Wis. 293, 295.

The statutory method of applying to the Commission for reconsideration or change in an order made by the Commission is an application for rehearing.

Wis. Stats. Sec. 196.405.

That was the procedure adopted by the complainant here, and the application was summarily denied by the Commission the same day it was argued.

XIII.

No Emergency Exists.

The Commission also seeks to justify its order under the so-called emergency provision of the Statutes, Sec. 196.70. The application of the emergency statute requires two prerequisites: first, that an emergency exists; secondly, that an order is necessary "to prevent injury to the business or interests of the people or any public utility." In this case, neither of the prerequisites was present.

An emergency is defined by Webster as: "an unforseen occurrence, or the combination of circumstances which calls for immediate action or remedy; pressing necessity; exigency."

Substantially this definition is used in

Colfax County v. *Butler County*, 83 Neb. 803, 120 N. W. 444.

Mallon v. *Board of Water Commrs.*, 128 S. W. 764, 765.

Seaboard Air Line Co. v. *McMichael*, 143 Ga. 689, 85 S. E. 891, 894.

None of these conditions exist in the present case; and no situation requiring immediate and drastic

action with respect to telephone rates is shown. The Commission relied on its so-called economic testimony, but none of this indicates that there is any pressing necessity that requires immediate action on telephone rates to be taken.

Further, there is also lacking the second statutory prerequisite, that the order is necessary to "prevent injury to the business or interests of the people or any public utility". No injury to any public utility is claimed to be threatened. So far as any threat of injury to the public is concerned, the total loss of stations by the complainant from the maximum (on May 31, 1931, was 5.15% (Comp. Aff., p. 189). Compared with the falling off of business in every other line, this amount is insignificant. The very smallness of the amount tends to prove the reasonableness of telephone rates, rather than to indicate that they injure the public interest. Further, the reduction of rates ordered by the Commission would amount to less than one cent a day for over half of the complainant's residence subscribers, and less than two cents a day for 97.8% of such subscribers; and less than three cents a day for 84.7% of the business subscribers. Taking all of complainant's subscribers together, 89.2% would receive a reduction of less than two cents per day, and 96.7% a reduction of less than three cents a day under the Commission's Order (Comp. Aff., p. 103). Certainly a reduction of so insignificant an amount is not a necessity to prevent injury to the business or interests of the people.

XIV.

The Commission's Procedure and Order Deny the Complainant Due Process of Law.

The complainant contends the Commission's Order was entered without due process of law because the

complainant was not afforded any opportunity to be heard. As against this, the Commission maintains that the complainant could have presented evidence at any time, and quotes statements of complainant's counsel that the complainant did not plan to present its evidence until the Commission's case was closed. It must be borne in mind, however, that the proceeding was instituted by the Commission on its own motion; that the complainant had no cause to maintain, nothing on which to present evidence, and nothing on which to argue until some sort of case had been made against it. The Commission does not controvert that it took the initiative in the proceeding and began to present its evidence at the opening of the hearing. The Commission had before it the complainant's reports filed in the regular course of its business. The hearing necessarily resolved itself to the Commission's comments or criticisms as to the complainant's revenues, expenses and property. The Commission placed its accountants and engineers in the Company's plant, and proceeded to investigate its records in the fall of 1931, and it called its first hearing on April 1, 1932. From that time on, the Commission proceeded to put in its evidence. Naturally, in any orderly proceeding, the complainant could not introduce its evidence until after the Commission's evidence was introduced, and the complainant knew what it had to rebut. Further: at the time the Commission's Order was made (June 30, 1932), cross examination of the Commission's witnesses had not been completed. The complainant was allowed time to prepare for such cross-examination, and preparation for cross examination involved the analysis of a very voluminous report and exhibits with several hundred pages of tabulations, and required a great amount of accounting and engineering study (Comp. Aff., p. 195).

No claim is made that any notice whatever was given to the complainant of the Commission's intention to enter a temporary order, or of its contemplation to make any order before the conclusion of the entire investigation. That is the normal procedure.

Due process of law requires the giving of "opportunity to cross-examine witnesses, to inspect documents, and offer explanation in rebuttal thereof".

Interstate Commerce Comm. v. *Louisville & Nashville Railroad Co.*, 227 U. S. 88, 93.

To the same effect are:

In re Rosser, 101 Fed. 562, 567.

Road Improvement Dist. #2 v. *Missouri Pac. R. Co.*, 275 Fed. 600, 604.

Mercantile Trust Co. v. *Texas & P. Ry.*, 51 Fed. 529, 542.

Wichita R. & L. v. *Public Utilities Com.*, 260 U. S. 548.

The cases cited by the defendant Commission in its Order do not sustain the procedure taken or contradict the proposition that an order cannot be made without full opportunity for cross examination and rebuttal or without notice of the contemplated order. In the case most relied on, *New England Divisions Case*, 261 U. S. 184, 200, the court expressly points out "that a full hearing is one in which *ample opportunity* is afforded to all parties to make, by evidence and argument, a showing fairly adequate to establish the propriety or impropriety, from the standpoint of justice and law, *of the step asked to be taken*" and the court points out that in that case "the commission recognized, and observed, these essentials of a full hearing" (italics ours).

Further, the whole conduct of the proceeding was one that denied the complainant a fair hearing. Even

though the Commission be an administrative body and its function merely quasi-judicial, yet in holding hearings, it must maintain the ordinary constitutional safeguards. The harm is intensified here by the fact that the Commission was prosecutor as well as judge. A party to a proceeding, much less the very persons conducting the hearing, should not depart from an impartial attitude. Yet in this case, during the course of the hearing, the Commission, at least, permitted its employes to prepare so-called releases for the press, delivered to newspapers in advance of the hearing, in which were set forth statements of testimony in form as if the testimony had already been given, which unwarrantedly made strong statements and drew derogatory and unfair inferences against the complainant. The Commission in its answer infers its right to issue such press releases (p. 22). The Complainant maintains that such conduct makes the whole proceeding arbitrary, and without due process of law. In this case, though the complainant asked that these releases be filed so that the complainant would have an opportunity to utilize the same for the purpose of cross-examining the witnesses who prepared them, the Commission either denied the application or by reserving its ruling on it, in effect denied it. Such procedure amounts to an arbitrary act, against which the courts afford relief.

See *Northern Pac. Railroad Comm.* v. *Dept. of Public Works*, 268 U. S. 39, 45.

Further, whatever presumption there may have been in favor of the Commission's action is negatived not only by the arbitrary conduct of the proceedings of the Commission, but also by the fact that the Commission acted as prosecutor.

Public Service Gas Co. v. *Commrs.*, 87 Atl. 651, 653.

It is respectfully submitted that complainant's application for an interlocutory injunction should be granted.

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